



## First Trust's Grayson: Interval Funds Are A Way To Zig Against The Market's Zag

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Michael Grayson, portfolio manager for First Trust Capital Management, where he oversees their Alternative Opportunities, Private Credit, and Real Assets funds. Read the Q&A below as Michael says that investors should be sacrificing some liquidity for the flexibility to get different assets into their portfolios and to have investments that capture most of the upside in bull-market times while protecting



capital during market dislocations. That's how the funds he manages have fared over the last two years, and he says that current market conditions are bringing out the best properties in interval funds, making them more attractive for investors now.

Michael Grayson

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**CHUCK JAFFE:** Michael Grayson, portfolio manager at First Trust Capital Management is here and we're talking interval funds now on The NAVigator. This is The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator's brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And today we are looking in the direction of interval funds with Michael Grayson, portfolio

manager at First Trust Capital Management, who runs the firm's flagship First Trust Alternative Opportunities Fund, that's ticker VFLEX, as well as the First Trust Private Credit Fund, FTPCX, and First Trust Real Assets Fund, FTREX. Now all of them are interval funds, I know you're thinking closed-end funds, but he just gave five-letter tickers, if you don't understand that difference we'll discuss why interval funds are different but they do trade under the traditional mutual fund ticker system. But if you want to learn all about those three funds and more, well, you can find all about what First Trust is doing at FTPortfolios.com. You can also learn more about interval funds, and closed-end funds and business development companies at AICAlliance.org, the website for the Active Investment Company Alliance. Michael Grayson, thanks so much for joining me on The NAVigator.

**MICHAEL GRAYSON:** Thanks Chuck, we appreciate you hosting us today.

**CHUCK JAFFE:** Let's start with a little refresher for anybody who maybe is unsure of what an interval fund is, about why this structure, which again I gave them five-letter ticker symbols but it's not the classic traditional mutual fund. Why this structure and why it works particularly well with the kind of assets you're using at First Trust.

**MICHAEL GRAYSON:** Certainly. For starters, the interval fund is very similar to an open-end mutual fund structure. It is a closed-end fund, but as the very similar tickers imply, there are similarities between mutual funds and interval funds in that interval funds are daily purchased just like a mutual fund, an investor gets in at NAV at the end of the day, there's no paperwork associated, they're click-to-buy funds with the five-symbol ticker symbol. They strike a daily NAV, as I mentioned. They're 1099 tax reporting, so there's no K1s associated. They're a very low investment minimums, so in our three interval funds in particular at First Trust we've set the minimums to \$1,000, so there's no prohibitively high minimums. And they are administratively very similar to a mutual fund in that they report right to your custodial account on a daily basis with a valuation. The one nuance is the quarterly liquidity of the interval fund, they do not provide daily liquidity, and so an investor will tender out of an interval fund on a quarterly basis. For our three funds that you mentioned, Chuck, that happens on the final trading day of the quarter, there's no paperwork associated, you just click to sell. With a ticker symbol you get you cash proceeds back the next day just like a mutual fund, except you can only exit four times a year on the calendar quarter-end.

**CHUCK JAFFE:** So that interval, that's the real selling point. Not necessarily to the consumers, consumers love liquidity, but they pay a price for it, and the price they pay is in the management of the assets. Because that lack of flexibility in terms of, hey, you can only get out four times, gives you as a manager much more flexibility. Explain how you're using it in your funds.

**MICHAEL GRAYSON:** Absolutely, that is the benefit of the structure from a portfolio management perspective, is that we do not have to satisfy daily redemptions for the fund. And so what that enables us to do is have the flexibility to invest in some really unique differentiated less liquid investments that you can't responsibly own in a daily liquid fund like a mutual fund or an ETF. And so if you are able to, as a portfolio manager, incorporate assets with slightly less liquidity, you can capture return and yield premiums for owning those slightly less liquid assets. And those less liquid assets fit the interval fund structure very well because you're only providing quarterly liquidity to investors. And so while a lot of times in the alternative space, for liquid alternative mutual funds, it has been challenging to generate a compelling absolute return or total return profile. Interval funds have been historically successful generating enhanced returns and yields, and the investors sacrifice a little bit of liquidity in order to generate that.

**CHUCK JAFFE:** So now let's dig in to the funds itself, and we'll start realistically and spend most of our time on the Alternative Opportunities Fund. In terms of that strategy, you guys came out with it for a reason, and why you think it works particularly well. Tell us that, explain that.

**MICHAEL GRAYSON:** Yes, the reason is, and we created this fund for ourselves in 2017 and then had the opportunity to start distributing externally to our advisory clients, and the reason we created this fund is it was very challenging for us to scalably incorporate private market focused alternative investments into an asset allocation portfolio. And so we were able to of course get exposure to stocks, get exposure to bonds, but how do we construct for ourselves, and now our clients of our interval fund, a true third leg of the stool? Or true third pillar alternative asset allocation to complement the stock and bond exposure? And through our research, we surmised that the interval fund was a really good vehicle for being able to own more differentiated alternative investments such as private equity, private real estate, private credit, hedge fund type strategies, as well as direct co-investments. And so those are

to us qualitatively speaking, the sub-alternative asset classes or alternative sectors that you should have in a portfolio to complement stocks and bonds. And so we created the VFLEX fund to really be a one-stop or single-ticket solution to give you access to each of those alternative sectors being, as I mentioned, private equity, private real estate, private credit, hedge funds, and co-investments.

**CHUCK JAFFE:** How correlated have the things you've been in been? Because that's a key issue for somebody who's going, "Okay, wait, I'm going to lock myself into something, not be able to get out necessarily anytime I want. But is my performance always in sync with the market?"

**MICHAEL GRAYSON:** At First Trust we really do pride ourselves on creating alternative funds that have a lack of correlation or directionality to both stock and bond markets. That is the core tenet of the fund, to provide a truly differentiated, non-directional return stream to stocks and bonds. I think the last two calendar years have been a really good example of the return and risk characteristics that we would expect from the VFLEX fund in particular. And so last year you had a market where equities were up 25-30% depending on the index, the VFLEX fund finished the year up 14% net. And so alternative asset classes oftentimes in bull markets will not keep up with traditional assets, and so we underperformed modestly that mid-20s return year for equity markets finishing off 14% net. And VFLEX this year is a really good example obviously a challenging or stressed market in traditional assets where you have a 60-40 portfolio, both stocks and bonds suffering double-digit drawdowns this year, and potentially worse within specific sectors. The VFLEX fund is roughly flat or unchanged on a year-to-date basis, and so really shows the capital preservation or protection characteristics that alternatives can provide a portfolio in a challenging market environment. And so to us, if we can capture a substantial amount of the upside in a bull market scenario like last year, 2021, and then be able to protect capital in a very severe market dislocation and sell off like we've seen year to date being flat for the VFLEX fund, that's a very attractive return stream within an investor's overall portfolio.

**CHUCK JAFFE:** You know, we talked about interval funds, and there's clear benefits, but when we're talking First Trust Real Assets, FTREX, is there a significant difference about what you can do in an interval fund with real assets that can't be done in a traditional fund? That may be one of those areas where somebody goes, "Wait, hold it, I understand the

benefits I'm getting when I use private credit and what have you when there's not a liquid market," but real assets, what are you getting into and what's the real benefit of the structure there?

**MICHAEL GRAYSON:** Yes, we are really trying to provide in all of our interval funds true private market type exposure that historically clients have only been able to obtain through limited partnership or private fund investing in real assets. So true private LP real estate-oriented investments are very attractive in that they have low volatility characteristics, and have very attractive total return and yield profiles, and specific to real assets and real estate you have great inflationary protection with those assets and so they've tended to perform very well in this type of inflationary environment. The problem with doing these investments in a private fund structure is that you have subscription documents where you need to provide your driver's license and you need to provide your social security number. Then you have infrequent pricing so it doesn't pull through to your custodial account where you get a daily price, instead you're getting a monthly statement or a quarterly statement. Then you have K1s, which are oftentimes delayed and delay your tax filings. And so for us the investments were great in the limited partnership or private fund space, the client experience, not so great. So what we look to do with our real assets fund, FTREX, just like VFLEX and our private credit interval fund, is provide those same types of private real estate and real asset investments except in a much more client-friendly structure; click-to-buy, low minimums, 1099, pull through right to your custodial statement. And so that's why we really love the interval fund for bridging the gap between what historically you've only been able to access in the limited partnership space, now we can bring that to a wider investment audience in a very client-friendly way.

**CHUCK JAFFE:** Michael, really interesting. I appreciate your time, thanks so much for joining me on The NAVigator.

**MICHAEL GRAYSON:** Likewise Chuck, we appreciate it and look forward to speaking with you soon.

**CHUCK JAFFE:** The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yes, that's me, and you can learn all about my show on your favorite podcast app or at MoneyLifeShow.com. To learn more about interval funds, closed-end funds, and business-development companies go to AICAlliance.org, the

website for the Active Investment Company Alliance, on LinkedIn and Facebook @AICAlliance. Thanks to my guest Michael Grayson, portfolio manager at First Trust Capital Management, who oversees First Trust Alternative Opportunities, First Trust Private Credit, and First Trust Real Assets. Interval funds that you can get more information on at FTPortfolios.com. The NAVigator podcast is new every Friday, and we'll be here over the holiday week. We hope you're thankful for your investing success in closed-end funds and that you have a Happy Thanksgiving!

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